



Financial Management Report as of September 30, 2008

AT A GLANCE:

General Fund revenues are behind last year by 1.2 percent. Sales tax revenue performance continues negative trend for third quarter 2008 (see page 5)

Development revenue down; plan check fees holding steady (see page 3)

Budget Open Houses
See sidebar story on page 2

Eastside home sales fall 16.6 percent; prices down 9.8 percent (see page 8)

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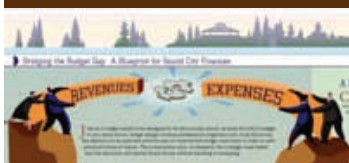
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Summary of All Operating Funds: *Revenue*

- General Fund** actual 2008 revenue is **1.2 percent behind** the same period last year largely due to disappointing sales tax revenue and a significant decline in building permit and planning fee revenue. A more detailed analysis of General Fund revenue can be found on page 3, and sales tax revenue performance can be found beginning on page 5.
- Other General Government Funds** actual 2008 revenue is **1.8 percent ahead** of the same period last year due to higher internal service rates, recreation fee revenue, and hotel tax revenue, as well as a significant insurance recovery for park property damage and despite a 10.5 percent decline in motor vehicle fuel tax revenue and variability in timing of cable tax revenue. Motor vehicle fuel tax is collected as a flat rate per gallon and distributed by the State based on population. Increased fuel costs that decrease consumption (fewer gallons sold) have a negative impact on this revenue.
- Water Sewer Operating Fund** actual 2008 revenue is **4.9 percent** ahead of last year due primarily to water and sewer revenue and a re-fund for prior year excise tax payments and despite a decline in regional connection fee revenue. Revenue was budgeted to increase 8 percent over 2007 due to higher rates.
- Surface Water Management Fund** Surface Water fees are paid through property tax collection, which are primarily received in April and October. Actual 2008 revenue is **1.0 percent ahead** of the same period last year, which is within a normal range of variability.
- Solid Waste Fund** revenue collection was budgeted to increase in 2008 over 2007 due to higher rates and normal growth. Actual 2008 revenue is **9.0 percent ahead** of the same period last year, which is higher than planned due to variability in billing collections.

Resources by Fund	Year-to-Date Actual			Budget			% of Budget	
	9/30/2007	9/30/2008	% Change	2007	2008	% Change	2007	2008
General Gov't Operating:								
General Fund	37,095,642	36,656,038	-1.2%	54,543,885	53,226,984	-2.4%	68.0%	68.9%
Other General Gov't Operating Funds	11,484,313	11,687,498	1.8%	16,736,577	17,027,124	1.7%	68.6%	68.6%
Total General Gov't Operating	48,579,955	48,343,536	-0.5%	71,280,462	70,254,108	-1.4%	68.2%	68.8%
Utilities:								
Water/Sewer Operating Fund	12,204,338	12,798,353	4.9%	16,494,804	17,821,208	8.0%	74.0%	71.8%
Surface Water Management Fund	2,943,672	2,972,695	1.0%	5,233,189	5,274,145	0.8%	56.3%	56.4%
Solid Waste Fund	5,784,336	6,304,258	9.0%	7,909,347	8,365,262	5.8%	73.1%	75.4%
Total Utilities	20,932,346	22,075,306	5.5%	29,637,340	31,460,615	6.2%	70.6%	70.2%
Total All Operating Funds	69,512,301	70,418,842	1.3%	100,917,802	101,714,723	0.8%	68.9%	69.2%

* Budgeted and actual revenues exclude resources forward and include interfund transfers.



The City of Kirkland hosted two Budget Open Houses to share the City's current and future financial condition, explain the challenges it faces for the upcoming biennium budget, and to discuss the proposed strategies that, if implemented, will balance the 2009-2010 Budget. Kirkland citizens and businesses were encouraged to attend the open houses.

In May, a revenue shortfall of over \$13 million was projected for the 2009-2010 Budget. The shortfall represents more than 12 percent of the General Fund Budget which supports essential services such as police, fire, emergency medical, transportation and parks services. The General Fund is primarily supported by sales tax, which has declined over the past several months. Limited property taxes, the current economic downturn, and increased costs for basic goods and services are also negatively impacting the City's financial picture. The City has the ability to reduce costs, raise revenue and use reserves as ways to balance the budget.

Kirkland residents and businesses received a special edition of City Update, the City's newsletter, which addresses how property taxes support general fund services and what sources of revenue the City receives to support those services. The publication also explains why there is a revenue shortfall in the upcoming budget and what strategies the City Council is considering to overcome the shortfall.

The City Council will be meeting starting October 30th and through November regarding the proposed 2009-10 Budget. A public hearing is scheduled for November 18th. The budget will be adopted in December.

Budget updates are available at the 2009-2010 Budget webpage at www.ci.kirkland.wa.us/budget.

Summary of All Operating Funds: *Expenditures*

- **General Fund** expenditures were budgeted to increase in 2008 over 2007 largely due to increased personnel costs. Actual expenditures are **9.1 percent ahead** of the same period last year primarily due to higher employee salary and benefit costs (including the settlement of labor contracts with back payments for 2007).
- **Other Operating Funds** expenditures were budgeted to decrease in 2008 over 2007 primarily due to the timing of vehicle purchases and one-time costs budgeted in 2007, and despite higher personnel costs. Actual expenditures are **3.2 percent ahead** of the same period last year primarily due to higher personnel and fuel costs, as well as timing of vehicle and computer purchases.
- **Water/Sewer Operating Fund** 2008 expenditures were budgeted to increase slightly over 2007 primarily due to one-time costs budgeted in 2007 and despite expected higher personnel, water purchase, and sewer processing costs in 2008. Actual 2008 expenditures are **4.3 percent ahead** of the same period last year primarily due to higher personnel, water purchase, and METRO sewer costs and despite a significant decline in regional water connection charges.
- **Surface Water Management Fund** expenditures were budgeted to decrease in 2008 over 2007 primarily due to the timing of one-time projects and despite higher personnel costs. Actual 2008 expenditures are **4.4 percent ahead** of the same period last year due to higher personnel costs and the progress made in 2008 on plans that were budgeted in 2007.
- **Solid Waste Fund** expenditures were budgeted to increase in 2008 over 2007 due primarily to higher solid waste contract rates. Actual 2008 expenditures are **18.9 percent ahead** of the same period last year due to the timing of monthly disposal contract billing payments.

Expenditures by Fund	Year-to-Date Actual			Budget			% of Budget	
	9/30/2007	9/30/2008	% Change	2007	2008	% Change	2007	2008
General Gov't Operating:								
General Fund	38,137,965	41,599,767	9.1%	54,678,073	56,620,925	3.6%	69.8%	73.5%
Other General Gov't Operating Funds	11,537,670	11,903,587	3.2%	17,318,967	16,843,501	-2.7%	66.6%	70.7%
Total General Gov't Operating	49,675,635	53,503,354	7.7%	71,997,040	73,464,426	2.0%	69.0%	72.8%
Utilities:								
Water/Sewer Operating Fund	12,219,624	12,744,562	4.3%	16,920,331	16,951,605	0.2%	72.2%	75.2%
Surface Water Management Fund	3,244,665	3,388,965	4.4%	5,646,269	5,520,982	-2.2%	57.5%	61.4%
Solid Waste Fund	5,201,114	6,186,373	18.9%	7,860,424	8,221,762	4.6%	66.2%	75.2%
Total Utilities	20,665,403	22,319,900	8.0%	30,427,024	30,694,349	0.9%	67.9%	72.7%
Total All Operating Funds	70,341,038	75,823,254	7.8%	102,424,064	104,158,775	1.7%	68.7%	72.8%

* Budgeted and actual expenditures exclude working capital, operating reserves, capital reserves, and include interfund transfers.

General Fund Revenue

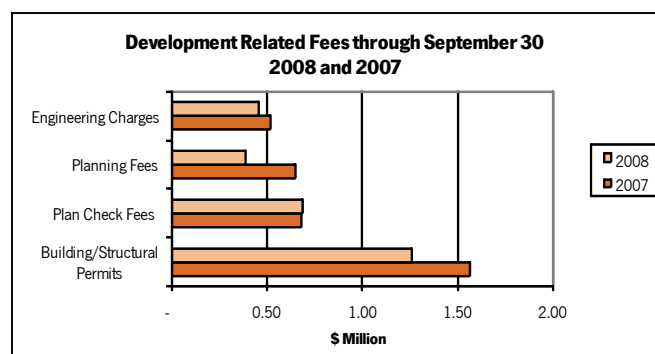
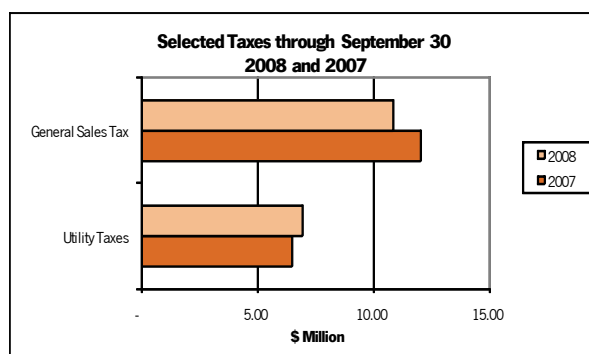
- **Sales tax** revenue for 2008 was originally planned to increase slightly over 2007. The budget was adjusted downward in March because of disappointing performance early in the year. However, actual 2008, General Fund sales tax revenue is continuing an even steeper decline, **down 9.7 percent** compared to the same period last year. A detailed analysis of **sales tax** revenue can be found starting on page 5.
- **Utility tax** actual revenue collection is **6.9 percent ahead** of the same period last year primarily due to growth in electricity and telephone tax revenue.
- **Other taxes** actual revenue is **19.4 percent ahead** of the same period last year primarily due to the one-time receipt of E-911 tax revenue for reimbursement of dispatch equipment and overtime.
- **Business licenses and franchise fees** actual revenue is **6.0 percent ahead** of the same period last year due to franchise fee revenue. The **revenue generating regulatory license** fee is **4.7 percent ahead** of the same period last year, in part due to collection of delinquent accounts. Variability of the timing of renewals from larger businesses can skew year-to-year comparisons.
- **Other licenses and permits** are **28.9 percent ahead** of the same period last year due to one-time revenue received for the Verizon fiber project inspections and alarm registrations.
- **Development-related fee** revenues remain a mixed bag. Collectively, actual 2008 revenue is **down 18.4 percent** compared to the same period last year. **Building/structural permits** actual 2008 revenue is **19.5 percent lower** than the same period in 2007. **Plan check** fees actual revenue is **1.0 percent ahead** compared to the same period in 2007. **Planning fees** are **down 40.8 percent** compared to the same period last year, and **engineering services** revenue is **down 12.4 percent** over the same period last year. The trends for development-related revenue in 2008 reflect the volatility that is inherent in development activity and also are reflected in sales tax revenue performance (see page 5).
- **Other charges for service** are **down 25.1 percent** compared to the same period last year due to lower probation revenue and one-time revenue received in 2007 for a temporary inspector for the Verizon fiber project.

General Fund 2008 revenues are \$0.44 million lower than the same period in 2007 largely due to slumping sales tax and development-related revenue and despite strong utility taxes revenues.

The General Fund is the largest of the General Government Operating funds. It is primarily tax supported and accounts for basic services such as public safety, parks and recreation, and community development.

General Fund Resource Category	Year-to-Date Actual			Budget			% of Budget	
	9/30/2007	9/30/2008	% Change	2007	2008	% Change	2007	2008
Taxes:								
Retail Sales Tax: General	12,022,001	10,854,713	-9.7%	15,918,981	15,756,800	-1.0%	75.5%	68.9%
Retail Sales Tax: Criminal Justice	851,707	860,505	1.0%	1,114,253	1,050,000	-5.8%	76.4%	82.0%
Property Tax	4,719,810	5,037,932	6.7%	8,790,086	9,037,710	2.8%	53.7%	55.7%
Utility Taxes	6,495,073	6,945,425	6.9%	8,723,683	8,145,822	-6.6%	74.5%	85.3%
Rev Generating Regulatory License	771,034	807,631	4.7%	936,671	990,000	5.7%	82.3%	81.6%
Other Taxes	343,650	410,343	19.4%	462,597	334,654	-27.7%	74.3%	122.6%
Total Taxes	25,203,275	24,916,549	-1.1%	35,946,271	35,314,986	-1.8%	70.1%	70.6%
Licenses & Permits:								
Building, Structural & Equipment Permits	1,562,497	1,258,548	-19.5%	2,078,436	2,163,450	4.1%	75.2%	58.2%
Business Licenses/Franchise Fees	1,092,343	1,157,481	6.0%	1,421,435	1,449,450	2.0%	76.8%	79.9%
Other Licenses & Permits	144,530	186,248	28.9%	188,749	193,900	2.7%	76.6%	96.1%
Total Licenses & Permits	2,799,370	2,602,277	-7.0%	3,688,620	3,806,800	3.2%	75.9%	68.4%
Intergovernmental:								
Grants	163,860	169,380	3.4%	182,160	36,784	-79.8%	90.0%	460.5%
State Shared Revenues & Entitlements	472,666	468,059	-1.0%	623,230	645,318	3.5%	75.8%	72.5%
Fire District #41	1,647,208	1,735,286	5.3%	3,184,310	3,487,428	N/A	51.7%	49.8%
EMS	-	396,512	N/A	504,376	793,023	N/A	N/A	50.0%
Other Intergovernmental Services	424,619	466,428	9.8%	589,478	439,609	-25.4%	72.0%	106.1%
Total Intergovernmental	2,708,353	3,235,665	19.5%	5,083,554	5,402,162	6.3%	53.3%	59.9%
Charges for Services:								
Internal Charges	2,531,279	2,393,244	-5.5%	3,443,777	3,511,012	2.0%	73.5%	68.2%
Engineering Services	516,753	452,585	-12.4%	635,000	610,000	-3.9%	81.4%	74.2%
Plan Check Fee	680,415	686,970	1.0%	958,760	900,000	-6.1%	71.0%	76.3%
Planning Fees	650,431	384,753	-40.8%	968,900	1,194,637	23.3%	67.1%	32.2%
Recreation	81,932	81,779	-0.2%	79,516	83,000	4.4%	103.0%	98.5%
Other Charges for Services	665,085	498,057	-25.1%	880,191	677,323	-23.0%	75.6%	73.5%
Total Charges for Services	5,125,895	4,497,388	-12.3%	6,966,144	6,975,972	0.1%	73.6%	64.5%
Fines & Forfeits	903,205	962,474	6.6%	1,317,860	1,132,000	-14.1%	68.5%	85.0%
Miscellaneous	355,544	412,847	16.1%	553,002	404,150	-26.9%	64.3%	102.2%
Total Revenues	37,095,642	36,627,200	-1.3%	53,555,451	53,036,070	-1.0%	69.3%	69.1%
Other Financing Sources:								
Interfund Transfers	-	28,838	N/A	988,434	190,914	N/A	N/A	15.1%
Total Other Financing Sources	-	28,838	N/A	988,434	190,914	N/A	N/A	15.1%
Total Resources	37,095,642	36,656,038	-1.2%	54,543,885	53,226,984	-2.4%	68.0%	68.9%

* Budgeted and actual revenues exclude resources forward.

General Fund Revenue *continued*

General Fund Expenditures

General Fund Department Expenditures	Year-to-Date Actual			Budget			% of Budget	
	9/30/2007	9/30/2008	% Change	2007	2008	% Change	2007	2008
Non-Departmental	722,353	982,951	36.1%	1,126,152	1,141,474	1.4%	64.1%	86.1%
City Council	235,517	294,319	25.0%	316,392	362,034	14.4%	74.4%	81.3%
City Manager's Office	2,156,454	2,623,422	21.7%	3,419,542	3,739,425	9.4%	63.1%	70.2%
Human Resources	730,029	769,934	5.5%	1,039,649	1,122,706	8.0%	70.2%	68.6%
City Attorney's Office	650,598	703,130	8.1%	957,460	991,985	3.6%	68.0%	70.9%
Parks & Community Services	4,134,206	4,405,893	6.6%	5,889,784	6,048,645	2.7%	70.2%	72.8%
Public Works (Engineering)	2,624,936	2,532,648	-3.5%	3,643,248	3,578,878	-1.8%	72.0%	70.8%
Finance and Administration	2,367,335	2,540,434	7.3%	3,420,487	3,536,915	3.4%	69.2%	71.8%
Planning & Community Development	2,386,928	2,523,009	5.7%	4,105,866	3,381,197	-17.6%	58.1%	74.6%
Police	9,842,041	11,449,757	16.3%	14,236,955	14,689,726	3.2%	69.1%	77.9%
Fire & Building	11,912,338	12,429,176	4.3%	15,817,178	16,846,282	6.5%	75.3%	73.8%
Total Expenditures	37,762,735	41,254,673	9.2%	53,972,713	55,439,267	2.7%	70.0%	74.4%
Other Financing Uses:								
Interfund Transfers	375,230	345,094	-8.0%	705,360	1,181,658	67.5%	53.2%	29.2%
Total Other Financing Uses	375,230	345,094	-8.0%	705,360	1,181,658	67.5%	53.2%	29.2%
Total Expenditures & Other Uses	38,137,965	41,599,767	1.2%	54,678,073	56,620,925	3.6%	69.8%	73.5%

* Budgeted and actual expenditures exclude working capital, operating reserves, and capital reserves.

2008 expenditure budgets were higher than 2007 for most departments primarily due to higher personnel costs, including an unsettled labor contract from 2007 that settled in 2008. In addition to this general trend, specific highlights and budget to actual comparisons by selected departments are listed below:

- Actual 2008 expenditures for the **City Council** are **25.0 percent ahead** of the same period last year primarily due to the cost of a one-time citizen survey and changes to Council salaries and benefits.
- Actual 2008 expenditures for the **City Manager's Office** are **21.7 percent ahead** of the same period last year primarily due to the payment of NORCOM regional dispatch transition costs and higher personnel salaries and benefit costs.
- Actual 2008 expenditures for the **City Attorney's Office** are **8.1 percent ahead** of the same period last year primarily due to higher legal services contract expenses from an increased number of court calendars as well as higher personnel salaries and benefit costs.
- Actual 2008 expenditures for the **Parks & Community Services Department** are **6.6 percent ahead** of the same period last year primarily due to the timing of human service agency contract payments and higher personnel costs.

Compared to 2007, 2008 General Fund actual expenditures are tracking ahead of last year primarily due to higher personnel costs, settlement of a labor contract that included back-pay for 2007 in 2008, and timing of major projects.

(Continued on page 5)

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- Actual 2008 expenditures for the **Public Works Department** are **3.5 percent behind** the same period last year primarily due to position vacancies and the completion of the one-time Verizon fiber project inspection.
- Actual 2008 expenditures for the **Finance & Administration Department** are **7.3 percent ahead** of the same time last year primarily due to position vacancies in 2007 and higher personnel costs in 2008.
- Actual 2008 expenditures for the **Planning Department** are **5.7 percent ahead** of the same time last year primarily due to the timing of payments to ARCH (A Regional Coalition for Housing), an environmental impact review for a downtown shopping center, and despite position vacancies.
- Actual 2008 expenditures for the **Police Department** are **16.3 percent ahead** of the same period last year due primarily to higher personnel costs, back payment of 2007 wages as a result of a labor contract settlement, staffing vacancies in 2007, and higher jail costs.
- Actual 2008 expenditures for the **Fire & Building Department** are **4.3 percent ahead** of the same period last year largely due to the timing of Fire dispatch contract costs. While down slightly from the same period last year, fire operations overtime costs remain a concern.

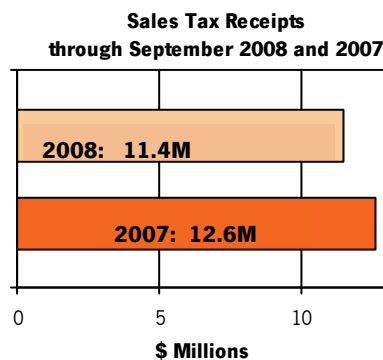


Kirkland Kid's Triathlon at Houghton Beach Park

Sales Tax Revenue Analysis 2008 actual revenue is down 9.3 percent compared to the same period last year primarily due to significant softening in contracting revenue, as well as declining revenue in key retail sectors. All business sectors except one are experiencing negative performance and revenue is almost \$1.2 million behind the same period in 2007. (See table on page 6).

Review by business sectors:

- The **contracting** sector is **down 14.7 percent** compared to the same period last year due to the completion of major projects and a general weakening in development activity. Although several large projects are currently underway, including the Google office complex, this activity hasn't replaced the level of activity occurring last year. An additional concern is whether any new projects are on the horizon to sustain the current level of activity.
- The **miscellaneous** sector is **down 29.3 percent** compared to last year primarily due to one-time revenue from an airplane lease received last year. Factoring out identified one-time events, this sector is about 5.4 percent behind the same period last year.
- The **auto/gas retail** sector is **down 6.9 percent** compared to the same period last year due to disappointing performance of key retailers and the loss of one retailer. In contrast, as of September 2007, this sector was more than \$290,000 ahead of the prior year.
- General merchandise/miscellaneous retail** is **down 7.0 percent** compared to the same period last year due to disappointing performance by key retailers.
- Wholesale** is **down 12.1 percent** compared to the same period last year primarily due to the difference in development-related purchases in 2008 compared to 2007.
- The **communications** sector is **down 20.1 percent** over the same period last year due to significant development activity in this sector last year and despite moderate growth in cellular phone services this year.
- Other retail declined 3.3 percent** compared to the same period last year due to the closure of two major retailers.
- The **services** sector performance is **down 2.3 percent** compared to the same period last year due to significant one-time development activity in 2007, the departure of a major bio-tech pharmaceutical research company, and despite the strength of the accommodations subsector. It should be noted that this sector is still experiencing development-related activity, just not consistently at the same level as last year.
- Retail eating/drinking** is the only sector with positive (although flat) performance, **up 0.3 percent** compared to the same period last year due to relatively stable results from several larger businesses as well as the collection of a past-due account from prior years.



Auto/ gas retail growth helped balance declines in development revenue in 2007, but is lagging throughout 2008.

Statewide, sales tax revenue is down largely due to slowing development and slumping automobile sales.

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City of Kirkland Actual Sales Tax Receipts

Business Sector Group	January - September		Dollar Change	Percent Change	Percent of Total	
	2007	2008			2007	2008
Services	1,432,719	1,399,713	(33,006)	-2.3%	11.4%	12.2%
Contracting	2,296,010	1,958,942	(337,068)	-14.7%	18.2%	17.1%
Communications	492,836	393,896	(98,940)	-20.1%	3.9%	3.4%
Auto/Gas Retail	2,342,930	2,180,633	(162,297)	-6.9%	18.6%	19.1%
Gen Merch/Misc Retail	1,979,114	1,841,370	(137,744)	-7.0%	15.7%	16.1%
Retail Eating/Drinking	968,212	970,850	2,638	0.3%	7.7%	8.5%
Other Retail	1,380,704	1,335,290	(45,414)	-3.3%	11.0%	11.7%
Wholesale	840,237	738,527	(101,710)	-12.1%	6.7%	6.5%
Miscellaneous	866,763	612,884	(253,879)	-29.3%	6.8%	5.4%
Total	12,599,525	11,432,105	(1,167,420)	-9.3%	100.0%	100.0%

Kirkland's sales tax base is comprised of a variety of businesses which are grouped and analyzed by business sector (according to NAICS, or "North American Industry Classification System"). Nine business sector groupings are used to compare 2007 and 2008 year-to-date sales tax receipts in the table to the left.

Month	Sales Tax Receipts		Dollar Change	Percent Change
	2007	2008		
January	1,267,021	1,227,855	(39,166)	-3.1%
February	1,525,665	1,586,493	60,828	4.0%
March	1,154,890	1,112,704	(42,186)	-3.7%
April	1,604,395	1,085,739	(518,656)	-32.3%
May	1,496,755	1,367,777	(128,978)	-8.6%
June	1,422,662	1,073,094	(349,568)	-24.6%
July	1,428,250	1,253,751	(174,499)	-12.2%
August	1,253,921	1,388,993	135,072	10.8%
September	1,445,966	1,335,699	(110,267)	-7.6%
Total	12,599,525	11,432,105	-1,167,420	-9.3%

When analyzing monthly sales tax receipts, there are two items of special note: First, most businesses remit their sales tax collections to the Washington State Department of Revenue on a monthly basis. Small businesses only have to remit their sales tax collections either quarterly or annually, which can create anomalies when comparing the same month between two years. Second, for those businesses which remit sales tax monthly, there is a two month lag from the time that sales tax is collected to the time it is distributed to the City. For example, sales tax received by the City in September is for sales actually made in July. Monthly sales tax receipts through September 2007 and 2008 are compared in the table to the left.

- February and August 2008 experienced the only positive monthly increases compared to the same month in the prior year since July 2007. However, August and April are both skewed by a significant adjustment to 2007 revenue (an overpayment received in April was credited in August). Normalized, the comparison for April is down about 22 percent and August is down about 5 percent compared to the same months in the prior year.
- Adjustments between May and June receipts also skew comparisons. Normalizing for the adjustments, May is down 14.9 percent compared to May 2007 and June is down 18 percent compared to June 2007.

Kirkland's sales tax base is further broken down by business district (according to geographic area), as well as "unassigned or no district" for small businesses and businesses with no physical presence in Kirkland.

Totem Lake, which accounts for almost 32 percent of the total sales tax receipts, is **down 4.0 percent** compared to the same period last year primarily due to

the closure of two major retailers and the departure of a pharmaceutical research company, and declines in the auto/gas retail sector. Almost 60 percent of this business district's revenue comes from the auto/gas retail and general merchandise/miscellaneous retail sectors.

NE 85th Street, which accounts for 15 percent of the total sales tax receipts, is **down 9.9 percent** compared to the same period last year primarily due to the automotive/gas retail and general merchandise/miscellaneous retail. Almost 86 percent of this business district's revenue comes from these two business sectors.

Downtown, which accounts for almost 8 percent of the total sales tax receipts, is **up 5.6 percent** compared to the same period last year primarily due to moderately strong performance in the retail eating/drinking and accommodations sectors, which provide 42 per-

cent of this business district's revenue as well as strong performance as a result of a new firm in the business services sector.

Carillon Point & Yarrow Bay, which accounts for almost 3 percent of the total sales tax receipts, is **down 11.4 percent** compared to the same period last year primarily due to poor performance from major software companies and retail eating/drinking and despite strong performance in the accommodations sector. Over 77 percent of this business district's revenue comes from business services, retail eating/drinking and hotels.

Houghton & Bridle Trails, which accounts for over 3 percent of the total sales tax receipts, is **down 13.3 percent** compared to the same period last year almost entirely due to miscellaneous retail, which provides about 45 percent of these business districts' revenue.

Juanita, which accounts for 2 percent of the total sales tax receipts, is **up 5.5 percent** compared to the same period last year primarily due to the retail eating/drinking sector, which provides over 40 percent of this business district's revenue.

When reviewing sales tax receipts by business district, it's important to point out that almost 40 percent of the revenue received in 2008 is in the "unassigned or no district" category largely due to contracting revenue (which has declined compared to last year), and increasing revenue from Internet, catalog sales and other businesses located outside of the City.

City of Kirkland Sales Tax by Business District

Business District	Jan - Sep Receipts		Dollar Change	Percent Change	Percent of Total	
	2007	2008			2007	2008
Totem Lake	3,761,452	3,609,713	(151,739)	-4.0%	29.9%	31.6%
NE 85th St	1,905,833	1,716,579	(189,254)	-9.9%	15.1%	15.0%
Downtown	831,446	878,300	46,854	5.6%	6.6%	7.7%
Carillon Pt & Yarrow Bay	346,193	306,722	(39,471)	-11.4%	2.7%	2.7%
Houghton & Bridle Trails	467,720	405,595	(62,125)	-13.3%	3.7%	3.5%
Juanita	214,691	226,506	11,815	5.5%	1.7%	2.0%
Unassigned or No District:						
Contracting	2,296,010	1,958,930	(337,080)	-14.7%	18.2%	17.1%
Other	2,776,180	2,329,760	(446,420)	-16.1%	23.8%	22.4%
Total	12,599,525	11,432,105	(1,167,420)	-9.3%	100.0%	100.0%

Sales Tax Revenue Outlook

Third quarter sales tax performance continues the negative trend for the year and demonstrates the volatility inherent in sales tax revenue. The disappointing performance in the retail sectors so far this year, especially automotive/gas retail and general merchandise/miscellaneous retail are concerning since these sectors represent the majority of the "ongoing" revenues in contrast with development activity, which is more one-time in nature. Declining retail sales tax revenue along with weakening development activity are threatening the City's ability to maintain existing services in the near future as well as deepening the budget gap for the upcoming biennium. Additional risks include the opening of Costco stores in Redmond and Bellevue by the end of 2009 and the plan for a major automobile dealership to relocate their sales activities outside the City limits. Potential opportunities include redevelopment of major retail centers, such as Totem Lake Mall and Park Place. However, even if these projects proceed, they will not be completed for some time. As a result, their ability to overcome the current risks is limited.

On a national level, the recent crises in the financial and insurance industries and the resulting rescue plan add to economic uncertainties, which could negatively impact the local economy. Washington has fared better than the rest of the country so far, but the significant economic events of the last several weeks will likely impact the economy for years to come. They also could permanently alter consumer spending habits and temporarily diminish the availability of financing for large projects as well.

OFFICE VACANCIES:

The Eastside vacancy rate remains low at 10.5 percent and Kirkland's rate is 7.8 percent as of the third quarter of 2008 according to CB Richard Ellis Real Estate Services. However, the third quarter saw the region's office market record the largest negative absorption in six years. JP Morgan's acquisition of Washington Mutual and Safeco becoming a subsidiary of Liberty Mutual add to the uncertainty for the local market.

LODGING TAX REVENUE:

Lodging tax 2008 revenue is up 24.3 percent compared to the same period last year due to overall strong performance in the accommodations industry as well as the new hotel, which opened downtown in late 2007.

Economic Environment Update

The national economic crisis is creating uncertainty in the local economy. The largest bank failure in U.S. history occurred when Washington Mutual collapsed and was acquired by J.P. Morgan Chase. Alaska Airlines and Weyerhaeuser are both eliminating 1,000 jobs each in the near future. However, local employment levels still remain strong with almost 130,000 jobs added in the Seattle-Tacoma metropolitan area since January 2005. The unemployment rate in King County is 4.3 percent as of August 2008, well below the national and Washington State average of 6.1 and 5.7 percent respectively. The full impact of the recent economic events on employment is not apparent from the current employment statistics.

The Puget Sound office market is facing a period of uncertainty with the recent acquisition of Washington Mutual and Safeco by outside corporations. However, there are companies like Microsoft and Amazon which continue major expansions. Amazon is building a 1.6 million square foot headquarters in the South Lake Union area of Seattle and Microsoft is expanding their Redmond campus and occupying significant space in downtown Bellevue.

In response to the national economic situation and the local Boeing strike, the September Western Washington purchasing managers survey monthly index plummeted 17.5 points to 48.3. The national index also dropped to 43.5. (It should be noted that a score of more than 50 points signals an expanding economy, while a score of less than 50 points indicates a shrinking economy.)

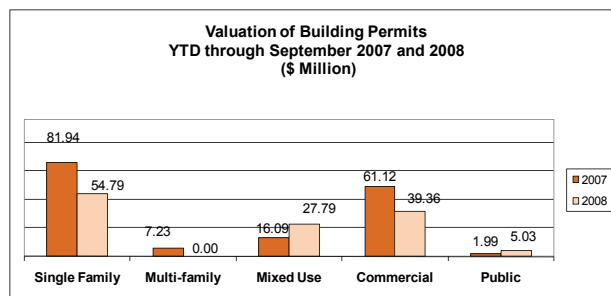
As mentioned in the sales tax analysis, significant risks from business changes and slowing development activity could pose a financial challenge in the near future for the City.

(Continued on page 8)

Economic Environment Update *continued*

Page 8

Local **development activity** comparing 2008 to 2007 as measured by the valuation of City of Kirkland building permits is illustrated in the chart to the right. Activity has dropped considerably—especially in the single family and multi-family sectors. The only positive growth in 2008 is in the mixed-use category due to two large complexes under development. Concerns about the slowing local real estate market and tight credit could have a significant impact on development activity in 2009.



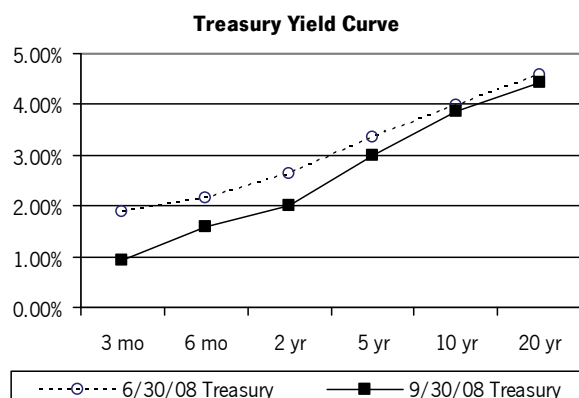
While prices continue a yearlong decline, the number of pending home sales in King County increased in September for the first time since the slump began last year. Even still, sales of **new and existing single-family homes** on the Eastside are down 16.6 percent in September 2008 compared with a year earlier and prices declined 9.8 percent for closed sales compared to the same month last year. The median price of a single family home in June was \$550,000—down from \$610,000 in September 2007. Eastside condominium prices actually edged up 0.3 percent compared to the same month last year from \$308,950 to \$310,000; although sales were down 44.6 percent.

Seattle metro CPI continues to track higher than the national average (6.2 percent compared to the national average of 5.9 percent as of August). The June 2008 CPI-W was 6.19 percent, which was higher than anticipated, creating additional budget concerns given that it is the measure referenced in City labor contracts for City employee cost of living adjustments (COLA).

Investment Report

MARKET OVERVIEW

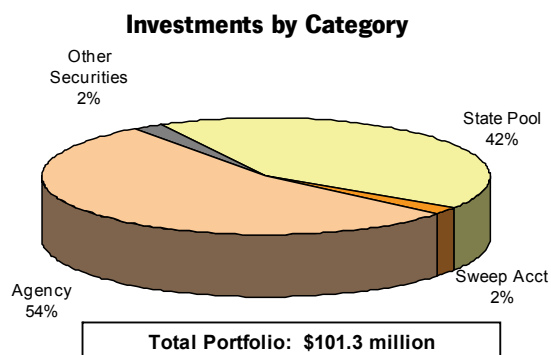
The market experienced unprecedented volatility near the end of the third quarter and the beginning of the fourth quarter including long standing institutions entering into bankruptcy (Lehman Brothers) or being sold (Washington Mutual) and Fannie Mae and Freddie Mac entering into conservatorship with the Federal Housing Finance Agency. To help stabilize the markets, the Federal Government has provided a tremendous supply of liquidity to the market. During this quarter the Fed Funds rate remained level at 2.00 percent for the third quarter and then dropped to 1.50 percent following the close of the quarter on October 8, 2008. The yield curve dropped during the quarter with short term rates dropping below 1 percent as can be seen in the accompanying graph.



CITY PORTFOLIO

It is the policy of the City of Kirkland to invest public funds in a manner which provides the highest investment return with maximum security while meeting the City's daily cash flow requirements and conforming to all Washington state statutes governing the investment of public funds.

The primary objectives for the City of Kirkland's investment activities are: legality, safety, liquidity and yield. Additionally, the City diversifies its investments according to established maximum allowable exposure limits so that reliance on any one issuer will not place an undue financial burden on the City. The value of the City's portfolio decreased approximately 4 percent in the third quarter of 2008. The portfolio's value changed from \$105.6 million on June 30, 2008 to \$101.3 million on September 30, 2008.



DIVERSIFICATION

The City's current investment portfolio is composed of Government Agency bonds, State and Local Government bonds, the State Investment Pool and an overnight bank sweep account. As noted earlier, Fannie Mae and Freddie Mac, two of the Government Sponsored Enterprises (GSEs), entered into conservatorship with the Federal Housing Finance Agency on September 7, 2008. This move, along with actions from the U.S. Treasury has enhanced the creditworthiness of these two GSEs. Additionally, on September 7, 2008, Standard & Poor's Ratings Services affirmed its long-term 'AAA' senior unsecured debt ratings on Fannie Mae and Freddie Mac based on the explicit government support under the terms of the conservatorship and the U.S. Treasury's establishment of a preferred stock purchase agreement. These moves help reinforce the Federal Government's support of these agencies.

Investment Report *continued***2008 ECONOMIC OUTLOOK
and INVESTMENT STRATEGY**

Growth in U.S. real output over the next few quarters looks slower now than it did just three months ago, according to 47 forecasters surveyed by the Federal Reserve Bank of Philadelphia. GDP growth for 2008 is now expected to be 1.2 percent, down from earlier forecasts of 1.7 percent. 2009 GDP growth is expected to be 1.5 percent. Core inflation for 2008 is expected to be 2.2 percent. The unemployment rate is expected to average 5.4 percent for 2008 and 6.0 percent for 2009. This is up from earlier estimates of 5.1 percent unemployment for 2008. The Fed Funds rate, currently at 1.5 percent as of October 8, 2008, is expected to drop further to 1.25 percent at the October 28-29 meeting.

While investment yield opportunities are limited during this period of low interest rates, the portfolio duration will move closer to the target range as the currently owned securities mature and are called. Additionally, investments maturing two years or less will be purchased in order to help bring the portfolio duration within target. Total investment income for 2008 is estimated to be \$4.5 million.

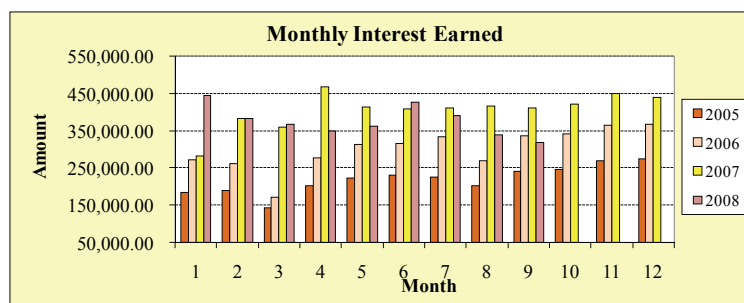
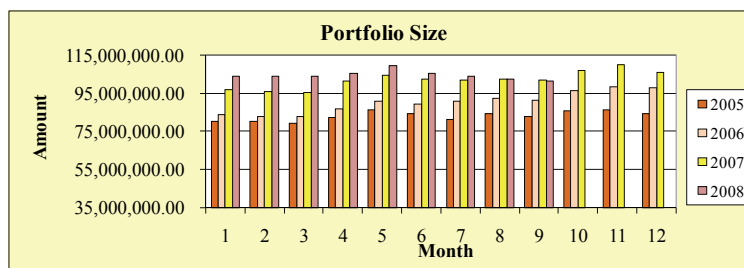
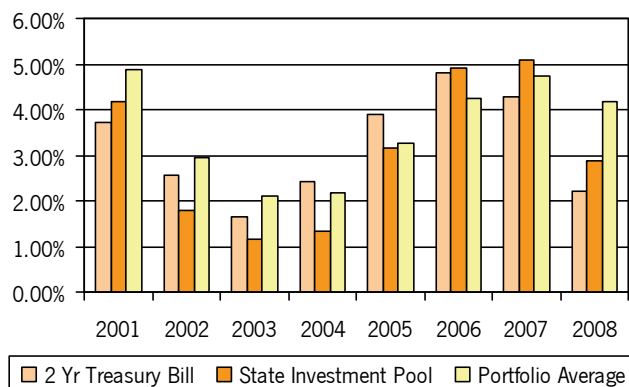
LIQUIDITY

The target duration for the City's portfolio is based on the 2-year treasury rate which decreased from 2.63 percent on June 30, 2008 to 2.00 percent on September 30, 2008. The average maturity of the City's investment portfolio decreased from 2.08 years to 1.82 years during this same period. The duration is above the target due to the purchase of longer term securities to lock in higher yields. It is expected that the portfolio duration will become shorter as those securities are called. It is likely that they will be called since interest rates have declined significantly from the time that those securities were purchased.

YIELD

The City portfolio's yield to maturity decreased from 3.98 percent on June 30, 2008 to 3.76 percent on September 30, 2008. Through September 30, 2008, the City's annual average yield to maturity was 4.16 percent, which exceeded the performance of the State Investment Pool whose annual average yield to maturity was 2.86 percent and above the 2-year Treasury note annual average for 2008 at 2.21 percent.

Benchmark Comparison	June 30, 2008	Sept. 30, 2008
City Yield to Maturity (YTM)	3.98%	3.76%
City Annual Average YTM	4.29%	4.16%
City Year to Date Cash Yield	4.66%	4.66%
State Pool Average Yield	3.12%	2.86%
2 yr Treasury Note Avg YTM	2.17%	2.21%

Investment Interest Rate Comparisons

Reserve Summary

General Operating Reserve

For the City's "Rainy Day" fund, the target is established by fiscal policy at five percent of the operating budget (excluding utility and internal service funds). Each year, the target amount will change proportional to the change in the operating budget. To maintain full funding, the increment between five percent of the previous year's budget and the current budget would be added or subtracted utilizing interest income and year-end transfers from the General Fund. It is a reserve to be used for unforeseen revenue losses and other temporary events. If the reserve is utilized by the City Council, the authorization should be accompanied by a plan for replenishing the reserve within a two to three year period.

Revenue Stabilization Reserve

The Revenue Stabilization Reserve was approved by Council in July 2003 and was created by segregating a portion of the General Operating Reserve. The purpose of this reserve is to provide an easy mechanism to tap reserves to address temporary revenue shortfalls resulting from temporary circumstances (e.g. economic cycles, weather-related fluctuations in revenue). Council set the target at ten percent of selected General Fund revenue sources which are subject to volatility (e.g. sales tax, development fees and utility taxes). The Revenue Stabilization Reserve may be used in its entirety; however, replenishing the reserve will constitute the first priority for use of year-end transfers from the General Fund.

Contingency Fund

The Contingency Fund was established pursuant to RCW 35A.33.145 to "provide monies with which to meet any municipal expense, the necessity or extent of which could not have been foreseen or reasonably evaluated at the time of adopting the annual budget." State law sets the maximum balance in the fund at \$.375 per \$1,000 of assessed valuation. This reserve would be used to address unforeseen expenditures (as opposed to revenue shortfalls addressed by the Revenue Stabilization Reserve). The fund can be replenished through interest earnings up to the maximum balance or through the year-end transfer if needed.

Reserves are an important indicator of the City's fiscal health. They effectively represent "savings accounts" that are established to meet unforeseen budgetary needs (general purpose reserves) or are otherwise dedicated to a specific purpose (special purpose reserves). The City's reserves are listed with their revised estimated balances at the end of the biennium in the table below:

Reserves	2007-08 Est End Balance	2007 Auth. Uses	2008 Auth. Uses	Revised 2007-08 End Balance
GENERAL PURPOSE RESERVES				
Contingency	3,193,826	365,936	250,339	2,577,551
General Capital Contingency	3,312,834		43,000	3,269,834
Park & Municipal Reserve:				
General Oper. Reserve (Rainy Day)	2,712,836			2,712,836
Revenue Stabilization Reserve	2,082,380			2,082,380
Building & Property Reserve	1,921,002	10,000		1,911,002
Council Special Projects Reserve	309,960	33,000	5,000	271,960
Total General Purpose Reserves	13,532,838	408,936	298,339	12,825,563
SPECIAL PURPOSE RESERVES				
Excise Tax Capital Improvement:				
REET 1	6,673,678	796,394		5,877,284
REET 2	6,067,898		35,000	6,032,898
Equipment Rental:				
Vehicle Reserve	5,907,138			5,907,138
Radio Reserve	36,000			36,000
Information Technology:				
PC Replacement Reserve	453,670			453,670
Major Systems Replacement Reserve	666,500			666,500
Facilities Maintenance:				
Operating Reserve	550,000			550,000
Facilities Sinking Fund	1,439,951			1,439,951
Impact Fees				
Roads	1,984,145			1,984,145
Parks	920,086			920,086
Park Bond Reserve	502,916			502,916
Cemetery Improvement	476,401			476,401
Off-Street Parking	29,564			29,564
Tour Dock	73,211			73,211
Street Improvement	1,121,498	161,100		960,398
Firefighter's Pension	1,359,860			1,359,860
Park & Municipal Reserve:				
Litigation Reserve	20,004			20,004
Labor Relations Reserve	51,255			51,255
Police Equipment Reserve	26,519			26,519
LEOFF 1 Police Reserve	625,754			625,754
Facilities Expansion Reserve	800,000			800,000
Development Services Reserve	1,290,831			1,290,831
Tree Ordinance	13,750			13,750
Donation Accounts	143,859			143,859
Revolving Accounts	148,606			148,606
Water/Sewer Operating Reserve	1,511,245		52,106	1,459,139
Water/Sewer Debt Service Reserve	820,155			820,155
Water/Sewer Capital Contingency	1,703,640	500,200	180,000	1,023,440
Water/Sewer Construction Reserve	8,738,358	835,000		7,903,358
Surface Water Operating Reserve	320,299			320,299
Surface Water Capital Contingency	876,760	202,000	195,400	479,360
Surface Water-Transp. Related Rsv	1,417,365	236,000		1,181,365
Surface Water Construction Reserve	1,240,563			1,240,563
Total Special Purpose Reserves	48,011,479	2,730,694	462,506	44,818,279
Grand Total	61,544,317	3,139,630	760,845	57,643,842

No Council Authorized Additions as of September 30, 2008.

Reserve Summary *continued*

USES AND ADDITIONS HIGHLIGHTS

RESERVE	AMOUNT	DESCRIPTION
2008 Council Authorized Uses		
Contingency Fund	\$250,339	Funding to completely pay the outstanding amount of leasehold excise tax credit to the Washington State Department of Revenue. The balance was the result of a refund in 2008 of the overpayment over the last three years by Evergreen Hospital.
General Capital Contingency	\$43,000	Additional funding for the NE 73rd Street Sidewalk project as a result of utilizing Low Impact Development (LID) approach - primarily added landscaping costs.
Council Special Projects Reserve	\$5,000	Funding for 2008 membership dues to the Cascade Land Conservancy to become a Cascade Agenda Leadership City.
Real Estate Excise Tax (REET) 2 Reserve	\$35,000	Funding for the Crosswalk upgrade program - NE 120th Place near the Casa Juanita Apartments.
Water/Sewer Operating Reserve	\$39,106	Funding for the emergency repair of a watermain leak on NE 85 th Street.
	\$13,000	Funding for the Lake Washington sewer basin smoke testing.
Water/Sewer Capital Contingency	\$180,000	Additional funding for the NE 73rd Street Sidewalk project for a watermain replacement and associated street overlay.
Surface Water Capital Contingency	\$158,500	Additional funding for the Juanita Creek Channel Enhancement project.
	\$36,900	Additional funding for the NE 126th Street/94th Avenue NE Channel Restoration project.

2008 Council Authorized Additions

No Council Authorized Additions as of September 30, 2008.

The summary in the section above details all Council authorized uses and additions to each reserve

Reserves	Revised 2007-08 End Balance	2007-08 Target	Over (Under) Target
GENERAL PURPOSE RESERVES			
Contingency	2,577,551	3,698,455	(1,120,904)
General Capital Contingency	3,269,834	5,822,280	(2,552,446)
Park & Municipal Reserve:			
General Oper. Reserve (Rainy Day)	2,712,836	3,134,779	(421,943)
Revenue Stabilization Reserve	2,082,380	2,143,422	(61,042)
Council Special Projects Reserve	271,960	250,000	21,960
General Purpose Reserves with Targets	10,914,561	15,048,936	(4,134,375)
SPECIAL PURPOSE RESERVES			
Excise Tax Capital Improvement:			
REET 1	5,877,284	1,435,000	4,442,284
REET 2	6,032,898	4,959,200	1,073,698
Information Technology:			
Major Systems Replacement Reserve	666,500	1,025,000	(358,500)
Firefighter's Pension	1,359,860	1,103,000	256,860
Park & Municipal Reserve:			
Litigation Reserve	20,004	50,000	(29,996)
LEOFF 1 Police Reserve	625,754	855,000	(229,246)
Development Services Reserve	1,290,831	1,290,831	0
Water/Sewer Operating Reserve	1,459,139	1,511,245	(52,106)
Water/Sewer Debt Service Reserve	820,155	820,155	0
Water/Sewer Capital Contingency	1,023,440	1,703,640	(680,200)
Surface Water Operating Reserve	320,299	320,299	0
Surface Water Capital Contingency	479,360	876,760	(397,400)
Special Purpose Reserves with Targets	19,975,524	15,950,130	4,025,394
Reserves without Targets	26,753,757	n/a	n/a
Total Reserves	57,643,842	n/a	n/a

The table to the left compares the revised ending balance to the targets established in the budget process .



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- ◆ Sandi Hines, Financial Planning Manager
- ◆ Sri Krishnan, Senior Financial Analyst
- ◆ Neil Kruse, Budget Analyst

www.ci.kirkland.wa.us

The Financial Management Report (FMR) is a high-level status report on the City's financial condition that is produced quarterly.

- It provides a **summary budget to actual comparison** for year-to-date revenues and expenditures for all operating funds. The report also compares this year's actual revenue and expenditure performance to the prior year.
- The **Sales Tax Revenue Analysis** report takes a closer look at the City's largest and most economically sensitive revenue source.
- **Economic environment** information provides a brief outlook at the key economic indicators for the Eastside and Kirkland such as office vacancies, residential housing prices/sales, development activity, inflation and unemployment.
- The **Investment Summary** report includes a brief market overview, a snapshot of the City's investment portfolio, and the City's year-to-date investment performance.
- The **Reserve Summary** report highlights the uses of and additions to the City's reserves in the current year as well as the projected ending reserve balance relative to each reserve's target amount.

Economic Environment Update References:

- Jon Talton, *The week that changed Seattle's economy*, The Seattle Times, September 28, 2008
- *Purchasing manager optimism falls in Western Washington*, Puget Sound Business Journal, October 7, 2008
- Eric Pryne, *King County home prices slide again, but more people are buying.*, The Seattle Times, October 7, 2008
- CB Richard Ellis Real Estate Services, Market View Puget Sound, Third Quarter 2008
- Washington State Employment Security Department
- Washington State Department of Revenue
- Washington State Department of Labor & Industries
- U.S. Bureau of Labor Statistics
- City of Kirkland Building Division
- City of Kirkland Finance Department